



Irving Trust

Economic Outlook

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Real economic growth appears to be moving into a more normal range after an extended slowdown. Growth in real GNP went from 0.3% at an annualized rate in the first quarter to 1.9% in the second quarter and 3.3% in the third quarter. It is likely that growth in the next several quarters will top the third quarter's rate. The pieces are in place for resumption of more satisfactory economic growth: a monetary policy that turned increasingly accommodative during the past year, significant depreciation of the dollar, and visible progress toward correcting inventory imbalances that developed during the slowdown. Nevertheless, there is much turmoil below the surface; signs of hesitancy abound.

To allay concerns that the improvement in real growth might not be sustained, Mr. Volcker seemed to go out of his way recently to indicate that the Fed has essentially become resigned to accepting above-target money growth this year. His statement gave further momentum to the rally in the stock market by intimating that if the economic turnaround fizzles out, it will not be because the Fed chased an errant monetary indicator. From our point of view, these developments reinforce the prospect that the economy will grow at more respectable rates in the quarters ahead. Real GNP is expected to increase 2.4% from the fourth quarter of 1984 to the fourth quarter of 1985 and 3.5% from the fourth quarter of this year to the fourth quarter of next year.

The monthly economic indicators continue to give erratic signals. For example, nonfarm payroll employment rose by a scant 138,000 in September, only to be followed by a robust gain of 414,000 in October. With so much attention on layoffs and the slowdown, it is sometimes forgotten that payrolls expanded by almost 3 million workers during the past 12 months. Retail sales have mirrored the roller coaster in auto sales, as total retail sales rose 2.1% in September and then plunged by a record 3.3% in October. If auto sales remain near current lackluster levels, it is likely that another round of incentive financing will be introduced early next year to boost sales (as assumed in our forecast). Nonauto retail sales showed month-to-month increases of 0.2% in September and 0.5% in October--basically mediocre performance. Even if nonauto retail sales continue to register only modest gains, many retailers will likely benefit from higher profit margins in the fourth quarter of this year compared to last year's results. Because of tight inventory control throughout 1985, the current situation is less promotional than a year ago, when inventories had become excessively high relative to sales.

In past business cycles, a set pattern of developments has usually been evident as the recovery matures. Capacity constraints develop; commodity prices rise as delivery times stretch out; and a recession ensues as monetary policy becomes increasingly restrictive to curb inflationary excesses. During the year prior to all recessions that occurred in the period 1960-1980, capacity utilization in manufacturing hit at least 85.6%. In September, capacity utilization was only 80.0%, while the peak rate in the current recovery was 81.8%. As a result, particularly in view of the willingness of foreign producers to serve U.S. markets, it appears that this recovery has ample room to continue.

Bernard Schoenfeld



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Economic Forecast

Percent Changes at Annual Rates

	Actual				Forecast				Actual	Forecast		
									1983-	1984-	1985-	
	I	II	III	1985		I	II	1986	1984	1985	1986	
				IV			III	IV				
Gross National Product	5.6	4.5	6.7	7.8		7.9	8.1	7.6	7.4	10.8	6.3	7.5
Real GNP	0.3	1.9	3.3	4.3		4.4	4.0	3.0	2.5	6.8	2.5	3.7
GNP Price Deflator	5.4	2.6	3.3	3.3		3.4	4.0	4.5	4.7	3.8	3.7	3.7

	Actual	Forecast	Actual	Forecast	
	1985:III	1985:IV	1983-1984	1984-1985	1985-1986
Consumer Spending	7.2%	4.6%	8.6%	7.2%	7.1%
Durable Goods	20.8	-11.5	13.9	7.8	4.2
Nondurable Goods	1.7	5.4	6.9	4.2	6.0
Services	7.6	8.8	8.5	9.2	8.8
Business Capital Spending	0.2	7.1	20.6	9.3	7.2
Structures	-3.5	7.5	16.0	11.0	6.2
Equipment	2.2	7.1	23.4	8.4	7.7
Residential Investment	14.4	8.5	16.4	4.5	1.7

			1984	1985	1986
Change in Inventories	\$-8.1b.	\$16.0b.	\$58.2b.	\$16.6b.	\$32.8b.
Net Exports of Goods and Services	\$-89.2b.	\$-92.0b.	\$-64.2b.	\$-87.4b.	\$-95.0b.

			1983-1984	1984-1985	1985-1986
Government Purchases	18.4%	6.1%	9.0%	10.6%	8.2%
Federal	31.2	2.3	9.5	13.4	7.0
Defense	21.4	9.4	10.5	11.4	9.1
Other	62.2	-15.0	6.7	19.5	1.1
State & Local	10.4	8.8	8.7	8.8	9.0
Corporate Profits Before Tax	0.0*	1.9*	16.0	-4.4	8.0
Corporate Profits After Tax	-1.4*	2.5*	14.5	-4.2	7.9
Plant and Equipment Expenditures	1.8	3.5	16.3	8.7	6.1
Real Final Sales*	5.9	1.8	5.0	3.6	3.3
Real Disposable Personal Income	-4.1	3.7	6.7	2.3	2.8

Economic Indicators	Recent Data			Actual	Forecast	
	Aug.	Sept.	Oct.	1983-1984	1984-1985	1985-1986
Consumer Price Index**	2.4%	2.4%	n.a.	4.0%	3.8%	4.4%
Producer Price Index for Finished Goods**	-3.6	-7.2	10.8%	1.7	1.1	3.3
Industrial Production	9.6	-1.2	0.0	11.5	2.3	3.4
Retail Sales**	2.8	2.1	-3.3	10.5	6.3	5.8

	1984	1985	1986
Auto Sales	12.6	14.5	9.6
(millions of units, a.r.)			
Housing Starts	1.75	1.58	n.a.
(millions of units, a.r.)			
Unemployment Rate	7.0%	7.1%	7.1%
Merchandise Trade Deficit (a.r.)	\$118.8b.	\$186.6b.	n.a.

Unless noted otherwise, all data are period-to-period percent changes at annual rates, derived from seasonally adjusted data.

*GNP less change in inventories, both in real terms.

**Monthly percent changes are not annualized.

*Year-over-year percent changes.

**Annual percent changes are December to December (not seasonally adjusted).

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\$b. = billions a.r. = annual rate F = Forecast